Waterstone Financial, Inc.
Form 10-K
March 06, 2019
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
F O R M 1 0 - K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018

Commission file number: 001-36271

WATERSTONE FINANCIAL, INC.
(Exact name of registrant as specified in its charter)

Maryland	90-1026709
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
11200 W Plank Ct, Wauwatosa, Wisconsin	53226
(Address of principal executive offices)	(Zip Code)

(414) 761-1000
Registrant's telephone number, including area code:

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, $0.01 Par Value	The NASDAQ Stock Market, LLC
(Title of class)	(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act:
NONE

Indicate by check mark whether the registrant is a well-known seasoned issuer (as defined in Rule 405 of the 1933 Act).
Yes No

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the 1934 Act.
Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files)
Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting Company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 under the Exchange Act).
Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, computed by reference to the price at which the common equity was last sold on June 30, 2018 as reported by the NASDAQ Global Select Market®, was approximately $499.9 million.

As of February 28, 2019 28,088,739 shares of the Registrant’s Common Stock were issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Document	Part of Form 10-K Into Which Portions of Document are Incorporated
Proxy Statement for Annual Meeting of Shareholders on May 21, 2019	Part III

WATERSTONE FINANCIAL, INC.

FORM 10-K ANNUAL REPORT TO THE SECURITIES AND EXCHANGE COMMISSION
FOR THE YEAR ENDED DECEMBER 31, 2018

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PART 1

Item 1. Business

Forward-Looking Statements

This Annual Report on Form 10-K may contain or incorporate by reference various forward-looking statements, which can be identified by the use of words such as “estimate,” “project,” “believe,” “intend,” “anticipate,” “plan,” “seek,” “ex and similar expressions and verbs in the future tense. These forward-looking statements include, but are not limited to:

- Statements of our goals, intentions and expectations;
- Statements regarding our business plans, prospects, growth and operating strategies;
- Statements regarding the quality of our loan and investment portfolio;
- Estimates of our risks and future costs and benefits.

These forward-looking statements are based on current beliefs and expectations of our management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements.

- general economic conditions, either nationally or in our market area, including employment prospects, that are different than expected;
- competition among depository and other financial institutions;
- inflation and changes in the interest rate environment that reduce our margins and yields, our mortgage banking revenues or reduce the fair value of financial instruments or reduce the origination levels in our lending business, or increase the level of defaults, losses or prepayments on loans we have made and make whether held in portfolio or sold in the secondary markets;
- adverse changes in the securities or secondary mortgage markets;
- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
- changes in monetary or fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board;
- our ability to manage market risk, credit risk and operational risk in the current economic conditions;
- our ability to enter new markets successfully and capitalize on growth opportunities;
- our ability to successfully integrate acquired entities;
- decreased demand for our products and services;
- changes in tax policies or assessment policies;
- the inability of third-party provider to perform their obligations to us;
- changes in consumer demand, spending, borrowing and savings habits;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission or the Public Company Accounting Oversight Board;
- our ability to retain key employees;
- cyber attacks, computer viruses and other technological risks that may breach the security of our websites or other systems to obtain unauthorized access to confidential information and destroy data or disable our systems;
- technological changes that may be more difficult or expensive than expected;
- the ability of third-party providers to perform their obligations to us;
- the effects of federal government shutdown;

- the ability of the U.S. Government to manage federal debt limits;
- significant increases in our loan losses; and
- changes in the financial condition, results of operations or future prospects of issuers of securities that we own.

See also the factors regarding future operations discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" below.

Waterstone Financial, Inc.

Waterstone Financial, Inc., a Maryland corporation ("New Waterstone"), was organized in 2013. Upon completion of the mutual-to-stock conversion of Lamplighter Financial, MHC in 2014, New Waterstone became the holding company of WaterStone Bank SSB and succeeded to all of the business and operations of Waterstone Financial, Inc., a Federal corporation ("Waterstone-Federal") and each of Waterstone-Federal and Lamplighter Financial, MHC ceased to exist. In this report, we refer to WaterStone Bank SSB, our wholly owned subsidiary, both before and after the reorganization, as "WaterStone Bank" or the "Bank."

New Waterstone did not engage in any business prior to the completion of the mutual-to-stock conversion of Lamplighter Financial, MHC on January 22, 2014. Consequently, this Annual Report on Form 10-K reflects the financial condition and operating results of Waterstone-Federal and its subsidiaries, including the Bank, until January 22, 2014, and of New Waterstone, and its subsidiaries, including the Bank, thereafter. The words "Waterstone Financial," "we" and "our" thus are intended to refer to Waterstone-Federal and its subsidiaries with respect to matters and time periods occurring on or before January 22, 2014, and to New Waterstone and its subsidiaries with respect to matters and time periods occurring thereafter.

Waterstone Financial, Inc. and its subsidiaries, including WaterStone Bank, are referred to herein as the “Company,” “Waterstone Financial,” or “we.”

The Company maintains a website at www.wsbonline.com. We make available through that website, free of charge, copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, amendments to those reports and proxy materials as soon as is reasonably practical after the Company electronically files those materials with, or furnishes them to, the Securities and Exchange Commission. You may access those reports by following the links under “Investor Relations” at the Company’s website. Information on this website is not and should not be considered a part of this document.

Waterstone Financial’s executive offices are located at 11200 West Plank Court, Wauwatosa, Wisconsin 53226, and its telephone number at this address is (414) 761-1000.

BUSINESS OF WATERSTONE BANK

General

WaterStone Bank is a community bank that has served the banking needs of its customers since 1921. WaterStone Bank also has an active mortgage banking subsidiary, Waterstone Mortgage Corporation, which had 78 offices in 23 states as of December 31, 2018.

WaterStone Bank conducts its community banking business from 11 banking offices located in Milwaukee, Washington and Waukesha counties, Wisconsin, as well as a loan production office in Minneapolis, Minnesota. WaterStone Bank’s principal lending activity is originating one- to four-family, multi-family residential, and commercial real estate loans for retention in its portfolio. At December 31, 2018, such loans comprised 35.5%, 43.3%, and 16.4%, respectively, of WaterStone Bank’s loan portfolio. WaterStone Bank also offers home equity loans and lines of credit, construction and land loans, commercial business loans, and consumer loans. WaterStone Bank funds its loan production primarily with retail deposits and Federal Home Loan Bank advances. Our deposit offerings include certificates of deposit, money market savings accounts, transaction deposit accounts, non-interest bearing demand accounts and individual retirement accounts. Our investment securities portfolio is comprised principally of mortgage-backed securities, government-sponsored enterprise bonds, municipal obligations, and other debt securities.

WaterStone Bank is subject to comprehensive regulation and examination by the Wisconsin Department of Financial Institutions (the "WDFI") and the Federal Deposit Insurance Corporation (the "FDIC").

WaterStone Bank’s executive offices are located at 11200 West Plank Court, Wauwatosa, Wisconsin 53226, and its telephone number is (414) 761-1000. Its website address is www.wsbonline.com. Information on this website is not and should not be considered a part of this document.

WaterStone Bank’s mortgage banking operations are conducted through its wholly-owned subsidiary, Waterstone Mortgage Corporation. Waterstone Mortgage Corporation originates single-family residential real estate loans for sale into the secondary market. Waterstone Mortgage Corporation utilizes lines of credit provided by WaterStone Bank as a primary source of funds, and also utilizes a line of credit with another financial institution as needed. On a consolidated basis, Waterstone Mortgage Corporation originated approximately $2.51 billion in mortgage loans held for sale during the year ended December 31, 2018, which excludes the loans originated from Waterstone Mortgage Corporation and purchased by WaterStone Bank.

Subsidiary Activities

Waterstone Financial currently has one wholly-owned subsidiary, WaterStone Bank, which in turn has three wholly-owned subsidiaries. Wauwatosa Investments, Inc., which holds and manages our investment portfolio, is located and incorporated in Nevada. Waterstone Mortgage Corporation is a mortgage banking business incorporated in Wisconsin. Main Street Real Estate Holdings, LLC is an inactive Wisconsin limited liability corporation and previously owned WaterStone Bank office facilities and held WaterStone Bank office facility leases.

Wauwatosa Investments, Inc. Established in 1998, Wauwatosa Investments, Inc. operates in Nevada as WaterStone Bank's investment subsidiary. This wholly-owned subsidiary owns and manages the majority of the consolidated investment portfolio. It has its own board of directors currently comprised of its President, the WaterStone Bank Chief Financial Officer, Treasury Officer and the Chairman of Waterstone Financial's board of directors.

Waterstone Mortgage Corporation. Acquired in February 2006, Waterstone Mortgage Corporation is a mortgage banking business with offices in 23 states. It has its own board of directors currently comprised of its President, its Chief Financial Officer, the WaterStone Bank Chief Executive Officer, Chief Financial Officer and Executive Vice President and General Counsel.

Main Street Real Estate Holdings, LLC. Established in 2002, Main Street Real Estate Holdings, LLC was established to acquire and hold WaterStone Bank office and retail facilities, both owned and leased. Main Street Real Estate Holdings, LLC currently conducts real estate broker activities limited to real estate owned.

Market Area

WaterStone Bank. WaterStone Bank's market area is broadly defined as the Milwaukee, Wisconsin metropolitan market, which is geographically located in the southeast corner of the state. WaterStone Bank's primary market area is Milwaukee and Waukesha counties and the five surrounding counties of Ozaukee, Washington, Jefferson, Walworth and Racine. We have six branch offices in Milwaukee County, four branch offices in Waukesha County and one branch office in Washington County. At June 30, 2018 (the latest date for which information was publicly available), 45.6% of deposits in the State of Wisconsin were located in the seven-county Milwaukee metropolitan market and 39.8% of deposits in the State of Wisconsin were located in the three counties in which the Bank has a branch office.

WaterStone Bank's primary market area for deposits includes the communities in which we maintain our banking office locations. Our primary lending market area is broader than our primary deposit market area and includes all of the primary market area noted above but extends further west to the Madison, Wisconsin market and further north to the Appleton and Green Bay, Wisconsin markets. Additionally, in 2013 we opened a loan production office in Minneapolis, Minnesota, which has a primary lending market area of the Minneapolis-St. Paul, Minnesota metropolitan market.

Waterstone Mortgage Corporation. As of December 31, 2018, Waterstone Mortgage Corporation had 11 offices in each of Wisconsin and Florida, eight offices in each of Pennsylvania and New Mexico, six offices in Minnesota, four offices in Ohio and Texas, three offices in Michigan, two offices in each of Arizona, California, Illinois, Iowa, Maryland, New Hampshire, Oregon, and Virginia, and one office in each of Colorado, Delaware, Georgia, Idaho, Nebraska, North Carolina and Oklahoma.

Competition

WaterStone Bank. WaterStone Bank faces competition within our market area both in making real estate loans and attracting deposits. The Milwaukee-Waukesha-West Allis metropolitan statistical area has a high concentration of financial institutions, including large commercial banks, community banks and credit unions. As of June 30, 2018, based on the FDIC annual Summary of Deposits Report, we had the ninth largest market share in our metropolitan statistical area out of 47 financial institutions, representing 1.69% of all deposits.

Our competition for loans and deposits comes principally from commercial banks, savings institutions, mortgage banking firms and credit unions. We face additional competition for deposits from money market funds, brokerage firms, and mutual funds. Some of our competitors offer products and services that we do not offer, such as trust services and private banking.

Our primary focus is to build and develop profitable consumer and commercial customer relationships while maintaining our role as a community bank.

Waterstone Mortgage Corporation. Waterstone Mortgage Corporation faces competition for originating loans both directly within the markets in which it operates and from entities that provide services throughout the United States through internet services. Waterstone Mortgage Corporation's competition comes principally from other mortgage banking firms, as well as from commercial banks, savings institutions and credit unions.

Lending Activities

The scope of the discussion included under "Lending Activities" is limited to lending operations related to loans originated for investment. A discussion of the lending activities related to loans originated for sale is included under "Mortgage Banking Activities."

Historically, our principal lending activity has been originating mortgage loans for the purchase or refinancing of residential and commercial real estate. Generally, we retain the loans that we originate, which we refer to as loans originated for investment. One- to four-family residential mortgage loans represented $490.0 million, or 35.5%, of our total loan portfolio at December 31, 2018. Multi-family residential mortgage loans represented $597.1 million, or 43.3%, of our total loan portfolio at December 31, 2018. Commercial real estate loans represented $225.5 million, or 16.4%, of our total loan portfolio at December 31, 2018. We also offer construction and land loans, home equity lines of credit and commercial loans. At December 31, 2018, commercial business loans, home equity loans, and land and construction loans totaled $32.8 million, $20.0 million and $13.4 million, respectively.

The largest exposure to one borrower or group of related borrowers was $41.0 million in the multi-family category. The borrower represented a total of 3.0% of the total loan portfolio as of December 31, 2018.

Loan Portfolio Composition. The following table sets forth the composition of our loan portfolio in dollar amounts and as a percentage of the total portfolio at the dates indicated.

	At December 31,									
	2018		2017		2016		2015		2014	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in Thousands)									
Mortgage loans:										
Residential real estate:										
One- to four-family	$489,979	35.53 %	$439,597	34.03 %	$392,817	33.35 %	$381,992	34.26 %	$411,979	37.62 %
Multi-family	597,087	43.29 %	578,440	44.77 %	558,592	47.42 %	547,250	49.08 %	522,281	47.70 %
Home equity	19,956	1.45 %	21,124	1.64 %	21,778	1.85 %	24,326	2.18 %	29,207	2.67 %
Construction and land	13,361	0.97 %	19,859	1.54 %	18,179	1.54 %	19,148	1.72 %	17,081	1.56 %
Commercial real estate	225,522	16.35 %	195,842	15.16 %	159,401	13.53 %	118,820	10.66 %	94,771	8.65 %
Commercial loans	32,810	2.38 %	36,697	2.84 %	26,798	2.28 %	23,037	2.07 %	19,471	1.78 %
Consumer	433	0.03 %	255	0.02 %	319	0.03 %	361	0.03 %	200	0.02 %
Total loans	1,379,148	100.00 %	1,291,814	100.00 %	1,177,884	100.00 %	1,114,934	100.00 %	1,094,990	100.00 %
Allowance for loan losses	(13,249)		(14,077)		(16,029)		(16,185)		(18,706)	
Loans, net	$1,365,899		$1,277,737		$1,161,855		$1,098,749		$1,076,284	

Loan Portfolio Maturities and Yields. The following table summarizes the final maturities of our loan portfolio at December 31, 2018. Maturities are based upon the final contractual payment dates and do not reflect the impact of prepayments and scheduled monthly payments that will occur.

	One- to four-family		Multi-family		Home Equity		Construction and Land	
Due during the year ended December 31,	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
	(Dollars in Thousands)							
2019	$7,928	5.59 %	$22,079	4.46 %	$2,239	5.62 %	$1,589	5.07 %
2020	3,715	4.79 %	48,593	4.17 %	2,467	5.73 %	128	4.75 %
2021	9,239	5.23 %	47,828	4.27 %	2,392	5.75 %	1,597	4.90 %
2022	25,523	5.25 %	89,274	4.45 %	3,181	5.48 %	59	6.00 %
2023	18,565	5.41 %	97,385	4.64 %	3,230	5.45 %	1,463	4.76 %
2024 and thereafter	425,009	4.59 %	291,928	4.39 %	6,447	4.92 %	8,525	4.52 %
Total	$489,979	4.68 %	$597,087	4.42 %	$19,956	5.38 %	$13,361	4.67 %

	Commercial Real Estate		Commercial		Consumer		Total	
Due during the year ended December 31,	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
	(Dollars in Thousands)							
2019	$18,897	4.88 %	$10,145	5.60 %	$205	8.51 %	$63,082	4.98 %
2020	14,936	4.36 %	6,285	5.07 %	28	4.00 %	76,152	4.37 %
2021	20,615	4.21 %	2,413	4.36 %	56	5.13 %	84,140	4.42 %
2022	32,758	4.30 %	4,883	4.37 %	17	5.00 %	155,695	4.57 %
2023	32,646	4.67 %	2,416	5.07 %	127	5.00 %	155,832	4.76 %
2024 and thereafter	105,670	4.34 %	6,668	6.69 %	-	0.00 %	844,247	4.51 %
Total	$225,522	4.42 %	$32,810	5.41 %	$433	6.61 %	$1,379,148	4.55 %

The following table sets forth the scheduled repayments of fixed and adjustable rate loans at December 31, 2018 that are contractually due after December 31, 2019.

	Due After December 31, 2019		
	Fixed	Adjustable	Total
	(In Thousands)		
Mortgage loans			
Real estate loans:			
One- to four-family	$18,335	$463,716	$482,051
Multi-family	233,389	341,619	575,008
Home equity	4,786	12,931	17,717
Construction and land	10,561	1,211	11,772
Commercial	117,363	89,262	206,625
Commercial	18,504	4,161	22,665
Consumer	228	-	228

Total loans	$403,166	$912,900	$1,316,066

One- to Four-Family Residential Mortgage Loans. One- to four-family residential mortgage loans totaled $490.0 million, or 35.5% of total loans at December 31, 2018. One- to four-family residential mortgage loans originated for investment during the year ended December 31, 2018 totaled $126.6 million, or 32.9% of all loans originated for investment. Our one- to four-family residential mortgage loans have fixed or adjustable rates. Our single family adjustable-rate mortgage loans generally provide for maximum annual rate adjustments of 200 basis points, with a lifetime maximum adjustment of 600 basis points. Our adjustable-rate mortgage loans typically amortize over terms of up to 30 years, and are indexed to the 12-month LIBOR rate. Single family adjustable rate mortgage loans are originated at both our community banking segment and our mortgage banking segment. We do not and have never offered residential mortgage loans specifically designed for borrowers with sub-prime credit scores, including Alt-A and negative amortization loans. Further, prior to 2007, we did not offer indexed, adjustable-rate loans other than home equity lines of credit, and we have never offered “teaser rate” first mortgage products.

Adjustable rate mortgage loans can decrease the interest rate risk associated with changes in market interest rates by periodically repricing, but involve other risks because, as interest rates increase, the loan payments by the borrower increase, thus increasing the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Upward adjustment of the contractual interest rate is also limited by the maximum periodic and lifetime interest rate adjustments permitted by our loan documents and, therefore, the effectiveness of adjustable rate mortgage loans in decreasing the risk associated with changes in interest rates may be limited during periods of rapidly rising interest rates. Moreover, during periods of rapidly declining interest rates the interest income received from the adjustable rate loans can be significantly reduced, thereby adversely affecting interest income.

All residential mortgage loans that we originate include "due-on-sale" clauses, which give us the right to declare a loan immediately due and payable in the event that, among other things, the borrower sells or otherwise transfers the real property subject to the mortgage and the loan is not repaid. We also require homeowner's insurance and where circumstances warrant, flood insurance, on properties securing real estate loans. The average one- to four-family first mortgage loan balance was $219,000 on December 31, 2018, and the largest outstanding balance on that date was $5.2 million, which is a consolidation loan that is collateralized by 80 single family properties. A total of 58.8% of our one- to four-family loans are collateralized by properties in the state of Wisconsin.

Multi-family Real Estate Loans. Multi-family loans totaled $597.1 million, or 43.3% of total loans at December 31, 2018. Multi-family loans originated for investment during the year ended December 31, 2018 totaled $123.1 million, or 32.0% of all loans originated for investment. These loans are generally secured by properties located in our primary market area. Our multi-family real estate underwriting policies generally provide that such real estate loans may be made in amounts of up to 80% of the appraised value of the property provided the loan complies with our current loans-to-one borrower limit. Multi-family real estate loans are offered with interest rates that are fixed for periods of up to five years or are variable and either adjust based on a market index or at our discretion. Contractual maturities do not exceed 10 years while principal and interest payments are typically based on a 30-year amortization period. In reaching a decision whether to make a multi-family real estate loan, we consider gross revenues and the net operating income of the property, the borrower's expertise and credit history, global cash flows, and the appraised value of the underlying property. We will also consider the terms and conditions of the leases and the credit quality of the tenants. We generally require that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before interest, income taxes, depreciation and amortization divided by interest expense and current maturities of long term debt) of at least 1.15 times. Generally, multi-family loans made to corporations, partnerships and other business entities require personal guarantees from the principals and by the owners of 20% or more of the borrower.

A multi-family borrower's financial information is monitored on an ongoing basis by requiring periodic financial statement updates, payment history reviews and periodic face-to-face meetings with the borrower. We generally require borrowers with aggregate outstanding balances exceeding $1.0 million to provide updated financial statements and federal tax returns annually. These requirements also apply to all guarantors on these loans. We also require borrowers with rental investment property to provide an annual report of income and expenses for the property, including a tenant list and copies of leases, as applicable. The average outstanding multi-family mortgage loan balance was $966,000 on December 31, 2018, with the largest outstanding balance at $13.4 million.

Loans secured by multi-family real estate generally involve larger principal amounts than owner-occupied, one- to four-family residential mortgage loans. Because payments on loans secured by multi-family properties often depend on the successful operation or management of the properties, repayment of such loans may be affected by adverse conditions in the real estate market or the economy.

Home Equity Loans and Lines of Credit. We also offer home equity loans and home equity lines of credit, both of which are secured by owner-occupied and non-owner occupied one- to four-family residences. At December 31, 2018, outstanding home equity loans and equity lines of credit totaled $20.0 million, or 1.5% of total loans outstanding. At December 31, 2018, the unadvanced portion of home equity lines of credit totaled $14.9 million. Home equity loans and lines originated for investment during the year ended December 31, 2018 totaled $4.6 million, or 1.2% of all loans originated for investment. The underwriting standards utilized for home equity loans and home equity lines of credit include a determination of the applicant's credit history, an assessment of the applicant's ability to meet existing obligations and payments on the proposed loan, and the value of the collateral securing the loan. Home equity loans are offered with adjustable rates of interest and with terms up to 10 years. The loan-to-value ratio for our home equity loans and our lines of credit is generally limited to 90% when combined with the first security lien, if applicable. Our home equity lines of credit have ten-year terms and adjustable rates of interest, subject to a contractual floor, which are indexed to the prime rate, as reported in The Wall Street Journal. Interest rates on home equity lines of credit are generally limited to a maximum rate of 18%. The average outstanding home equity loan balance was $44,000 at December 31, 2018, with the largest outstanding balance at that date of $532,000.

Construction and Land Loans. We originate construction loans for the acquisition of land and the construction of single-family residences, multi-family residences, and commercial real estate buildings. At December 31, 2018, construction and land loans totaled $13.4 million, or 1.0% of total loans. Construction and land loans originated for investment during the year ended December 31, 2018 totaled $66.3 million, or 17.2% of all loans originated for investment. Of the $66.3 million originated in 2018, a total of $59.0 million had yet to be advanced. At December 31, 2018, the unadvanced portion of the construction loan portfolio totaled $79.8 million.

Our construction mortgage loans generally provide for the payment of interest only during the construction phase, which is typically up to nine months for single-family residences although our policy is to consider construction periods as long as 12 months or more for multi-family residences and commercial buildings. At the end of the construction phase, the construction loan converts to a longer-term mortgage loan. Construction loans can be made with a maximum loan-to-value ratio of 90%, provided that the borrower obtains private mortgage insurance if the owner-occupied residential loan balance exceeds 80% of the lesser of the appraised value or acquisition cost of the secured property. The average outstanding construction loan balance totaled $1.3 million on December 31, 2018, with the largest outstanding balance at $3.9 million. The average outstanding land loan balance was $144,000 on December 31, 2018, and the largest outstanding balance on that date was $684,000.

Before making a commitment to fund a construction loan, we require an appraisal of the property by an independent licensed appraiser. We also review and inspect each property before disbursement of funds during the term of the construction loan. Loan proceeds are disbursed after inspection based on either the percentage of completion method or the actual cost of the completed work.

Construction financing is generally considered to involve a higher degree of credit risk than longer-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost (including interest) of construction and other assumptions. If the estimate of construction cost is inaccurate, we may be required to advance funds beyond the amount originally committed in order to protect the value of the property. Additionally, if the estimate of value is inaccurate, we may be confronted with a project, when completed, with a value that is insufficient to ensure full repayment of the loan.

Commercial Real Estate Loans. Commercial real estate loans totaled $225.5 million at December 31, 2018, or 16.4% of total loans, and are made up of loans secured by office and retail buildings, industrial buildings, churches, restaurants, other retail properties and mixed use properties. Commercial real estate loans originated for investment during the year ended December 31, 2018 totaled $58.2 million, or 15.1% of all loans originated for investment. These loans are generally secured by property located in our primary market area. Our commercial real estate underwriting policies provide that such real estate loans may be made in amounts of up to 80% of the appraised value of the property. Commercial real estate loans are offered with interest rates that are fixed up to five years or are variable and either adjust based on a market index or at our discretion. Contractual maturities do not exceed 10 years while principal and interest payments are typically based on a 25-30-year amortization period. In reaching a decision whether to make a commercial real estate loan, we consider gross revenues and the net operating income of the property, the borrower's expertise and credit history, business and global cash flow, and the appraised value of the underlying property. In addition, we will also consider the terms and conditions of the leases and the credit quality of the tenants, if applicable. We generally require that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before interest, income taxes, depreciation and amortization divided by interest expense and current maturities of long term debt) of at least 1.15 times. Environmental surveys are required for commercial real estate loans when environmental risks are identified. Generally, commercial real estate loans made to corporations, partnerships and other business entities require personal guarantees by the principals and by the owners of 20% or more of the borrower.

A commercial real estate borrower's financial information is monitored on an ongoing basis by requiring periodic financial statement updates, payment history reviews and periodic face-to-face meetings with the borrower. We generally require borrowers with aggregate outstanding balances exceeding $1.0 million to provide annual updated financial statements and federal tax returns. These requirements also apply to all guarantors on these loans. We also require borrowers to provide an annual report of income and expenses for the property, including a tenant list and copies of leases, as applicable. The average commercial real estate loan in our portfolio at December 31, 2018 was $842,000, and the largest outstanding balance at that date was $8.8 million.

Commercial Loans. Commercial loans totaled $32.8 million at December 31, 2018, or 2.4% of total loans, and are made up of loans secured by accounts receivable, inventory, equipment and real estate. Commercial loans originated for investment during the year ended December 31, 2018 totaled $6.2 million, or 1.6% of all loans originated.

Our commercial loans are generally made to borrowers that are located in our primary market area. Working capital lines of credit are granted for the purpose of carrying inventory and accounts receivable or purchasing equipment. These lines require that certain collateral levels must be maintained and are monitored on a monthly or quarterly basis. Working capital lines of credit are short-term loans of 12 months or less with variable interest rates. At December 31, 2018, the unadvanced portion of working capital lines of credit totaled $16.8 million. Outstanding balances fluctuate up to the maximum commitment amount based on fluctuations in the balance of the underlying collateral. Personal property loans secured by equipment are considered commercial business loans and are generally made for terms of up to 84 months and for up to 80% of the value of the underlying collateral. Interest rates on equipment loans may be either fixed or variable. Commercial business loans are generally variable rate loans with initial fixed rate periods of up to five years.

A commercial business borrower's financial information is monitored on an ongoing basis by requiring periodic financial statement updates, usually quarterly, payment history reviews and periodic face-to-face meetings with the borrower. The average outstanding commercial loan at December 31, 2018 was $220,000 and the largest outstanding balance on that date was $6.5 million.

The following table shows loan origination, principal repayment activity, transfers to real estate owned, charge-offs and sales during the years indicated.

	As of or for the Year Ended December 31,		
	2018	2017	2016
	(In Thousands)		
Total gross loans receivable and held for sale at beginning of year	$1,441,710	$1,403,132	$1,281,450
Real estate loans originated for investment:			
Residential			
One- to four-family	126,601	117,747	78,045
Multi-family	123,107	108,380	118,072
Home equity	4,613	5,430	5,037
Construction and land	66,265	2,270	5,878
Commercial real estate	58,176	61,684	35,443
Total real estate loans originated for investment	378,762	295,511	242,475
Consumer loans originated for investment	142	80	-
Commercial loans originated for investment	6,221	19,610	11,692
Total loans originated for investment	385,125	315,201	254,167
Principal repayments	(297,162)	(197,623)	(185,020)
Transfers to real estate owned	(545)	(2,171)	(4,590)
Loan principal charged-off	(84)	(1,477)	(1,607)
Net activity in loans held for investment	87,334	113,930	62,950
Loans originated for sale	2,509,827	2,458,370	2,378,926
Loans sold	(2,518,107)	(2,533,722)	(2,320,194)
Net activity in loans held for sale	(8,280)	(75,352)	58,732
Total gross loans receivable and held for sale at end of year	$1,520,764	$1,441,710	$1,403,132

Origination and Servicing of Loans. All loans originated for investment are underwritten pursuant to internally developed policies and procedures. While we generally underwrite owner-occupied residential mortgage loans to Freddie Mac and Fannie Mae standards, due to several unique characteristics, our loans originated prior to 2008 do not conform to the secondary market standards. The unique features of these loans include interest payments in advance of the month in which they are earned and discretionary rate adjustments that are not tied to an independent index.

Exclusive of our mortgage banking operations, we retain in our portfolio all of the loans that we originate. At December 31, 2018, WaterStone Bank was not servicing any loan it originated and subsequently sold to unrelated third parties. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent mortgagors, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans.

Loan Approval Procedures and Authority. WaterStone Bank's lending activities follow written, non-discriminatory, underwriting standards and loan origination procedures established by WaterStone Bank's board of directors. The loan approval process is intended to assess the borrower's ability to repay the loan, the viability of the loan and the adequacy of the value of the property that will secure the loan, if applicable. To assess the borrower's ability to repay, we review the employment and credit history and information on the historical and projected income and expenses of borrowers.

Loan officers, with concurrence from independent credit officers and underwriters, are authorized to approve and close any loan that qualifies under WaterStone Bank underwriting guidelines within the following lending limits:

A secured one- to four-family mortgage loan up to $500,000 for a borrower with total outstanding loans from us of less than $1.0 million that is independently underwritten can be approved by select loan officers.

A loan up to $500,000 for a borrower with total outstanding loans from us of less than $500,000 can be approved by select commercial loan officers.

Any secured mortgage loan ranging from $500,001 to $3,000,000 or any new loan to a borrower with outstanding loans from us exceeding $1.0 million must be approved by the Officer Loan Committee.

Any non-real estate loan ranging from $500,001 to $3,000,000 or any new non-real estate loan to a borrower with outstanding loans exceeding $500,000 must be approved by the Officer Loan Committee.

Any new loan over $3.0 million must be approved by the Officer Loan Committee and the board of directors prior to closing. Any new loan to a borrower with outstanding loans from us exceeding $10.0 million must be reviewed by the board of directors.

Asset Quality

When a loan becomes more than 30 days delinquent, WaterStone Bank sends a letter advising the borrower of the delinquency. The borrower is given a specific date by which delinquent payments must be made or by which they must contact WaterStone Bank to make arrangements to bring the loan current over a longer period of time. If the borrower fails to bring the loan current within the specified time period or to make arrangements to cure the delinquency over a longer period of time, the matter is referred to legal counsel and foreclosure or other collection proceedings are considered.

All loans are reviewed on a regular basis, and loans are placed on non-accrual status when they become 90 or more days delinquent. When loans are placed on non-accrual status, unpaid accrued interest is reversed, and further income is recognized only to the extent received when collection of the remaining principal balance is reasonably assured.

Non-Performing Assets. Non-performing assets consist of non-accrual loans and other real estate owned. Loans are generally placed on non-accrual status when contractually past due 90 days or more as to interest or principal payments. Additionally, whenever management becomes aware of facts or circumstances that may adversely impact the collectability of principal or interest on loans, management may place such loans on non-accrual status immediately, rather than waiting until the loan becomes 90 days past due. At the time a loan is placed on non-accrual status, previously accrued and uncollected interest on such loans is reversed and additional income is recorded only to the extent that payments are received and the collection of principal is reasonably assured. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

The table below sets forth the amounts and categories of our non-accrual loans and real estate owned at the dates indicated.

	At December 31,				
	2018	2017	2016	2015	2014
	(Dollars in Thousands)				
Non-accrual loans:					
Residential					
One- to four-family	$4,902	$4,677	$7,623	$13,888	$23,918
Multi-family	1,309	1,007	1,427	2,553	12,001
Home equity	201	107	344	437	445
Construction and land	-	-	-	239	401
Commercial real estate	125	251	422	460	947
Commercial	18	26	41	27	299
Consumer	-	-	-	-	-
Total non-accrual loans	6,555	6,068	9,857	17,604	38,011
Real estate owned					
One- to four-family	163	1,330	2,141	4,610	10,896
Multi-family	-	-	-	209	2,210
Construction and land	3,327	4,582	5,082	5,262	5,400
Commercial real estate	300	300	300	300	300
Total real estate owned	3,790	6,212	7,523	10,381	18,806
Valuation allowance at end of period	(1,638)	(1,654)	(1,405)	(1,191)	(100)
Total real estate owned, net	2,152	4,558	6,118	9,190	18,706
Total non-performing assets	$8,707	$10,626	$15,975	$26,794	$56,817
Total non-accrual loans to total loans, net	0.48 %	0.47 %	0.84 %	1.58 %	3.47 %
Total non-accrual loans to total assets	0.34 %	0.34 %	0.55 %	1.00 %	2.13 %
Total non-performing assets to total assets	0.45 %	0.59 %	0.89 %	1.52 %	3.18 %

All loans that meet or exceed 90 days with respect to past due principal and interest are recognized as non-accrual. Troubled debt restructurings which are still on non-accrual status either due to being past due 90 days or greater, or which have not yet performed under the modified terms for a reasonable period of time, are included in the table above. In addition, loans which are past due less than 90 days are evaluated to determine the likelihood of collectability given other credit risk factors such as early stage delinquency, the nature of the collateral or the results of a borrower fiscal review. When the collection of all contractual principal and interest is determined to be unlikely, the loan is moved to non-accrual status and an updated appraisal of the underlying collateral is ordered. This process generally takes place between contractual past due dates 60 and 90 days. Upon determining the updated estimated value of the collateral, a loan loss provision is recorded to establish a specific reserve to the extent that the outstanding principal balance exceeds the updated estimated net realizable value of the collateral. When a loan is determined to be uncollectible, generally coinciding with the initiation of foreclosure action, the specific reserve is reviewed for adequacy, adjusted if necessary, and charged-off.

The following table sets forth activity in our non-accrual loans for the years indicated.

	At and for the Year Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in Thousands)				

Balance at beginning of year	$6,068	$9,857	$17,604	$38,011	$50,961
Additions	3,147	3,149	3,114	10,165	21,585
Transfers to real estate owned	(545)	(2,171)	(4,590)	(15,580)	(16,645)
Charge-offs	(6)	(766)	(667)	(3,809)	(7,099)
Returned to accrual status	(777)	(2,716)	(4,183)	(5,824)	(4,470)
Principal paydowns and other	(1,332)	(1,285)	(1,421)	(5,359)	(6,321)
Balance at end of year	$6,555	$6,068	$9,857	$17,604	$38,011

Total non-accrual loans increased by $487,000, or 8.0%, to $6.6 million as of December 31, 2018 compared to $6.1 million as of December 31, 2017. The ratio of non-accrual loans to total loans receivable was 0.48% at December 31, 2018 compared to 0.47% at December 31, 2017. During the year ended December 31, 2018, $545,000 was transferred to real estate owned, $6,000 in loan principal was charged off, $1.3 million in principal payments were received and $777,000 in loans were returned to accrual status. Offsetting this activity, $3.1 million in loans were placed on non-accrual status during the year ended December 31, 2018.

Of the $6.6 million in total non-accrual loans as of December 31, 2018, $5.4 million in loans have been specifically reviewed to assess whether a specific valuation allowance is necessary. A specific valuation allowance is established for an amount equal to the impairment when the carrying value of the loan exceeds the present value of expected future cash flows, discounted at the loan's original effective interest rate or the fair value of the underlying collateral with an adjustment made for costs to dispose of the asset. Based upon these specific reviews, a total of $1.5 million in partial charge-offs have been recorded with respect to these loans as of December 31, 2018. Partially charged-off loans measured for impairment based upon net realizable collateral value are maintained in a "non-performing" status and are disclosed as impaired loans. In addition, specific reserves totaling $113,000 have been recorded as of December 31, 2018. The remaining $1.1 million of non-accrual loans were reviewed on an aggregate basis and $224,000 in general valuation allowance was deemed necessary related to those loans as of December 31, 2018. The $224,000 in general valuation allowance is based upon a migration analysis performed with respect to similar non-accrual loans in prior periods.

The outstanding principal balance of our five largest non-accrual loans as of December 31, 2018 totaled $1.9 million, which represents 28.6% of total non-accrual loans as of that date. These five loans did not have any charge-offs or require any specific valuation allowances as of December 31, 2018.

For the year ended December 31, 2018, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was $497,000. We received $376,000 of interest payments on such loans during the year ended December 31, 2018. Interest payments received are treated as interest income on a cash basis as long as the remaining book value of the loan (i.e., after charge-off of all identified losses) is deemed to be fully collectible. If the remaining book value is not deemed to be fully collectible, all payments received are applied to unpaid principal. Determination as to the ultimate collectability of the remaining book value is supported by an updated credit department evaluation of the borrower's financial condition and prospects for repayment, including consideration of the borrower's sustained historical repayment performance and other relevant factors.

There were no accruing loans past due 90 days or more during the years ended December 31, 2018, 2017 or 2016.

Troubled Debt Restructurings. The following table summarizes troubled debt restructurings by the Company's internal risk rating.

	At December 31,				
	2018	2017	2016	2015	2014
	(Dollars in Thousands)				
Troubled debt restructurings					
Substandard	$4,256	$5,035	$7,025	$14,436	$22,629
Watch	2,476	47	3,112	3,103	3,488
Total troubled debt restructurings	$6,732	$5,082	$10,137	$17,539	$26,117

Troubled debt restructurings totaled $6.7 million at December 31, 2018, compared to $5.1 million at December 31, 2017. At December 31, 2018, $6.2 million of troubled debt restructurings, or 91.9%, were performing in accordance with their restructured terms. All troubled debt restructurings are considered to be impaired and are risk rated as either substandard or watch and are included in the internal risk rating tables disclosed in the notes to the consolidated financial statements. Specific reserves have been established to the extent that the collateral-based impairment analyses indicate that a collateral shortfall exists or to the extent that a discounted cash flow analysis results in an impairment.

We do not participate in government-sponsored troubled debt restructuring programs. Our troubled debt restructurings are short-term modifications. Typical initial restructured terms include six to twelve months of principal forbearance, a reduction in interest rate or both. Restructured terms do not include a reduction of the outstanding principal balance unless mandated by a bankruptcy court. Troubled debt restructuring terms may be renewed or further modified at the end of the initial term for an additional period if performance has been acceptable and the short-term borrower difficulty persists.

Information with respect to the accrual status of our troubled debt restructurings is provided in the following table.

	At December 31,			
	2018		2017	
	Accruing	Non-accruing	Accruing	Non-accruing
	(In Thousands)			
One- to four-family	$2,740	$ 844	$2,740	$ 1,156
Multi-family	-	372	-	815
Home equity	-	-	47	-
Construction and land	-	-	-	-
Commercial real estate	2,759	17	290	34
	$5,499	$ 1,233	$3,077	$ 2,005

The following table sets forth activity in our troubled debt restructurings for the years indicated.

	At or for the Year Ended December 31,			
	2018		2017	
	Accruing	Non-accruing	Accruing	Non-accruing
	(In Thousands)			
Balance at beginning of year	$3,077	$ 2,005	$6,154	$ 3,983
Additions	2,476	-	-	-
Change in accrual status	-	-	-	-
Charge-offs	-	-	-	-
Returned to contractual/market terms	(46)	-	(3,063)	(1,756)
Transferred to real estate owned	-	-	-	-
Principal paydowns and other	(8)	(772)	(14)	(222)
Balance at end of period	$5,499	$ 1,233	$3,077	$ 2,005

For the year ended December 31, 2018, gross interest income that would have been recorded had our troubled debt restructurings been current in accordance with their contractual terms was $507,000. We received $491,000 of interest payments on such loans during the year ended December 31, 2018. Interest payments received on non-accrual troubled debt restructurings are treated as interest income on a cash basis as long as the remaining book value of the loan (i.e., after charge-off of all identified losses) is deemed to be fully collectible. If the remaining book value is not deemed to be fully collectible, all payments received are applied to unpaid principal. Determination as to the ultimate collectability of the remaining book value is supported by an updated credit department evaluation of the borrower's financial condition and prospects for repayment, including consideration of the borrower's sustained historical repayment performance and other relevant factors.

If a restructured loan is current in all respects and a minimum of six consecutive restructured payments have been received, it can be considered for return to accrual status. After a restructured loan that is current in all respects reverts to contractual/market terms, if a credit department review indicates no evidence of elevated market risk, the loan is removed from the troubled debt restructuring classification.

Loan Delinquency. The following table summarizes loan delinquency in total dollars and as a percentage of the total loan portfolio:

	At December 31,	
	2018	2017
	(Dollars in Thousands)	
Loans past due less than 90 days	$1,925	$1,878
Loans past due 90 days or more	5,025	3,974
Total loans past due	$6,950	$5,852
Total loans past due to total loans receivable	0.50 %	0.45 %

Past due loans increased by $1.1 million, or 18.8%, to $7.0 million at December 31, 2018 from $5.9 million at December 31, 2017. Loans past due 90 days or more increased by $1.1 million, or 26.4%, during the year ended December 31, 2018 and loans past due less than 90 days increased by $47,000, or 2.5%. The $1.1 million increase in loans past due 90 days or more was primarily due to an increase in the one- to four-family real estate loans of $318,000 and an increase in the multi family loans of $745,000 during the year ended December 31, 2018.

Potential Problem Loans. We define potential problem loans as substandard loans which are still accruing interest. We do not necessarily expect to realize losses on potential problem loans, but we recognize potential problem loans carry a higher probability of default and require additional attention by management. The aggregate principal amounts of potential problem loans as of December 31, 2018 and 2017 were $4.5 million and $5.5 million, respectively. Management believes it has established an adequate allowance for probable loan losses as appropriate under generally accepted accounting principles.

Real Estate Owned. Total real estate owned decreased by $2.4 million, or 52.8%, to $2.2 million at December 31, 2018, compared to $4.6 million at December 31, 2017. During the year ended December 31, 2018, $545,000 was transferred from loans to real estate owned upon completion of foreclosure. During the same period, sales of real estate owned totaled $2.6 million. Write-downs totaled $309,000 during the year ended December 31, 2018.

New appraisals received on real estate owned and collateral dependent impaired loans are based upon an "as is value" assumption. During the period of time in which we are awaiting receipt of an updated appraisal, loans evaluated for impairment based upon collateral value are measured by the following:

Applying an updated adjustment factor to an existing appraisal;

Confirming that the physical condition of the real estate has not significantly changed since the last valuation date;

Comparing the estimated current value of the collateral to that of updated sales values experienced on similar collateral;

Comparing the estimated current value of the collateral to that of updated values seen on current appraisals of similar collateral; and

Comparing the estimated current value to that of updated listed sales prices on our real estate owned and that of similar properties (not owned by the Company).

We owned 12 properties at December 31, 2018, compared to 33 properties as of December 31, 2017 and 30 properties at December 31, 2016. Habitable real estate owned is managed with the intent of attracting a lessee to generate revenue. Foreclosed properties are transferred to real estate owned at estimated net realizable value, with charge-offs, if any, charged to the allowance for loan losses upon transfer to real estate owned. The fair value is primarily based upon updated appraisals in addition to an analysis of current real estate market conditions.

Allowance for Loan Losses

We establish valuation allowances on loans that are deemed to be impaired. A loan is considered impaired when, based on current information and events, it is probable that we will not be able to collect all amounts due according to the contractual terms of the loan agreement. A valuation allowance is established for an amount equal to the impairment when the carrying amount of the loan exceeds the present value of the expected future cash flows, discounted at the loan's original effective interest rate or the fair value of the underlying collateral.

We also establish valuation allowances based on an evaluation of the various risk components that are inherent in the loan portfolio. The risk components that are evaluated include past loan loss experience; the level of non-performing and classified assets; current economic conditions; volume, growth, and composition of the loan portfolio; adverse situations that may affect the borrower's ability to repay; the estimated value of any underlying collateral; regulatory guidance; and other relevant factors. The allowance is increased by provisions charged to earnings and recoveries of previously charged-off loans and reduced by charge-offs. The appropriateness of the allowance for loan losses is reviewed and approved quarterly by the WaterStone Bank board of directors. The allowance reflects management's best estimate of the amount needed to provide for the probable loss on impaired loans and other inherent losses in the loan portfolio, and is based on a risk model developed and implemented by management and approved by the WaterStone Bank board of directors.

Actual results could differ from this estimate, and future additions to the allowance may be necessary based on unforeseen changes in loan quality and economic conditions. In addition, the Federal Deposit Insurance Corporation and the WDFI, as an integral part of their examination process, periodically review WaterStone Bank's allowance for loan losses. Such regulators have the authority to require WaterStone Bank to recognize additions to the allowance based on their judgments of information available to them at the time of their review or examination.

Any loan that is 90 or more days past due is placed on non-accrual and classified as a non-performing loan. A loan is classified as impaired when it is probable that we will be unable to collect all amounts due in accordance with the terms of the loan agreement. Non-performing loans are then evaluated and accounted for in accordance with generally accepted accounting principles.

The following table sets forth activity in our allowance for loan losses for the years indicated.

	At or for the Year Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in Thousands)				
Balance at beginning of year	$14,077	$16,029	$16,185	$18,706	$24,264
Provision (credit) for loan losses	(1,060)	(1,166)	380	1,965	1,150
Charge-offs:					
Mortgage loans					
One- to four-family	69	1,364	1,003	3,855	2,424
Multi-family	14	92	489	2,281	5,247
Home equity	1	-	112	72	191
Construction and land	-	14	3	84	496
Commercial real estate	-	7	-	45	199
Consumer	-	-	-	3	5
Commercial	-	-	-	-	293
Total charge-offs	84	1,477	1,607	6,340	8,855
Recoveries:					
Mortgage loans					
One- to four-family	159	293	811	649	1,833
Multi-family	89	208	152	992	189
Home equity	26	26	36	110	14
Construction and land	40	162	72	58	75
Commercial real estate	2	1	-	40	27
Consumer	-	1	-	5	6
Commercial	-	-	-	-	3
Total recoveries	316	691	1,071	1,854	2,147
Net (recoveries) charge-offs	(232)	786	536	4,486	6,708
Allowance at end of year	$13,249	$14,077	$16,029	$16,185	$18,706
Ratios:					
Allowance for loan losses to non-performing loans at end of year	202.12%	231.99%	162.62%	91.94%	49.21%
Allowance for loan losses to loans outstanding at end of year	0.96%	1.09%	1.36%	1.45%	1.71%
Net (recoveries) charge-offs to average loans outstanding	(0.02%)	0.06%	0.05%	0.37%	0.55%
Current year provision (credit) for loan losses to net (recoveries) charge-offs	456.90%	(148.35%)	70.90%	43.80%	17.14%
Net (recoveries) charge-offs to beginning of the year allowance	(1.65%)	4.90%	3.31%	23.98%	27.65%

Allocation of Allowance for Loan Losses. The following table sets forth the allowance for loan losses allocated by loan category, the total loan balances by category, and the percent of loans in each category to total loans at the dates indicated. The allowance for loan losses allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

At December 31,		
2018	2017	2016

	Allowance for Loan Losses	% of Loans in Category to Total Loans	% of Allowance in Category to Total Allowance	Allowance for Loan Losses	% of Loans in Category to Total Loans	% of Allowance in Category to Total Allowance	Allowance for Loan Losses	% of Loans in Category to Total Loans	% of Allowance in Category to Total Allowance
	(Dollars in Thousands)								
Real Estate:									
Residential									
One- to four-family	$5,742	35.53 %	43.34 %	$5,794	34.03 %	41.16 %	$7,164	33.35 %	44.69 %
Multi-family	4,153	43.29 %	31.35 %	4,431	44.77 %	31.48 %	4,809	47.42 %	30.00 %
Home equity	325	1.45 %	2.45 %	356	1.64 %	2.53 %	364	1.85 %	2.27 %
Construction and land	400	0.97 %	3.02 %	949	1.54 %	6.74 %	1,016	1.54 %	6.34 %
Commercial real estate	2,126	16.35 %	16.05 %	1,881	15.16 %	13.36 %	1,951	13.53 %	12.17 %
Commercial	483	2.38 %	3.65 %	656	2.84 %	4.66 %	713	2.28 %	4.45 %
Consumer	20	0.03 %	0.15 %	10	0.02 %	0.07 %	12	0.03 %	0.07 %
Total allowance for loan losses	$13,249	100.00 %	100.00 %	$14,077	100.00 %	100.00 %	$16,029	100.00 %	100.00 %

	At December 31, 2015			2014		
	Allowance for Loan Losses	% of Loans in Category to Total Loans	% of Allowance in Category to Total Allowance	Allowance for Loan Losses	% of Loans in Category to Total Loans	% of Allowance in Category to Total Allowance
	(Dollars In Thousands)					
Real Estate:						
Residential						
One- to four-family	$7,763	34.26 %	47.96 %	$9,877	37.62 %	52.80 %
Multi-family	5,000	49.08 %	30.89 %	5,358	47.70 %	28.64 %
Home equity	433	2.18 %	2.68 %	422	2.67 %	2.26 %
Construction and land	904	1.72 %	5.59 %	687	1.56 %	3.67 %
Commercial real estate	1,680	10.66 %	10.38 %	1,951	8.65 %	10.43 %
Commercial	396	2.07 %	2.45 %	403	1.78 %	2.15 %
Consumer	9	0.03 %	0.06 %	8	0.02 %	0.04 %
Total allowance for loan losses	$16,185	100.00 %	100.00 %	$18,706	100.00 %	100.00 %

All impaired loans meeting the criteria established by management are evaluated individually, based primarily on the value of the collateral securing each loan and the ability of the borrowers to repay according to the terms of the loans, or based upon an analysis of the present value of the expected future cash flows under the original contract terms as compared to the modified terms in the case of certain troubled debt restructurings. Specific loss allowances are established as required by this analysis. At least once each quarter, management evaluates the appropriateness of the balance of the allowance for loan losses based on several factors some of which are not loan specific, but are reflective of the inherent losses in the loan portfolio. This process includes, but is not limited to, a periodic review of loan collectability in light of historical experience, the nature and volume of loan activity, conditions that may affect the ability of the borrower to repay, underlying value of collateral and economic conditions in our immediate market area. All loans for which a specific loss review is not required are segregated by loan type and a loss allowance is established by using loss experience data and management’s judgment concerning other matters it considers significant including trends in non-performing loan balances, impaired loan balances, classified asset balances and the current economic environment. The allowance is allocated to each category of loans based on the results of the above analysis.

Our underwriting policies and procedures emphasize that credit decisions must rely on both the credit quality of the borrower and the estimated value of the underlying collateral. Credit quality is assured only when the estimated value of the collateral is objectively determined and is not subject to significant fluctuation.

The allowance for loan losses has been determined in accordance with GAAP. We are responsible for the timely and periodic determination of the amount of the allowance required. Any future provisions for loan losses will continue to be based upon our assessment of the overall loan portfolio and the underlying collateral, trends in non-performing loans, current economic conditions and other relevant factors. To the best of management's knowledge, all probable losses have been provided for in the allowance for loan losses.

The establishment of the amount of the loan loss allowance inherently involves judgments by management as to the appropriateness of the allowance, which ultimately may or may not be correct. Higher than anticipated rates of loan default would likely result in a need to increase provisions in future years.

At December 31, 2018, the allowance for loan losses was $13.2 million, compared to $14.1 million at December 31, 2017. As of December 31, 2018, the allowance for loan losses to total loans receivable was 0.96% and 202.12% of non-performing loans, compared to 1.09%, and 231.99%, respectively at December 31, 2017. The decrease in the allowance for loan losses during the year ended December 31, 2018 reflects a continued stabilization in the quality of the loan portfolio and continued improvement in the overall risk profile of the loan portfolio.

Net recoveries totaled $232,000, or 0.02% of average loans for the year ended December 31, 2018, compared to net charge-offs $786,000, or 0.06% of average loans for the year ended December 31, 2017. The $1.0 million decrease in net charge-offs was primarily the result of a decrease in charge-offs in the one- to four-family loan category offset primarily by decreases in recoveries in the multi-family and construction and land loan categories. Net charge-offs related to loans secured by one- to four-family residential loans decreased $1.2 million, or 108.4%, to $90,000 in net recoveries for year ended December 31, 2018, as compared to net charge-offs of $1.1 million for the year ended December 31, 2017. Partially offsetting the decrease, net recoveries related to loans secured by multi-family residential loans decreased $41,000, or 35.3%, to net recoveries of $75,000 for year ended December 31, 2018, as compared to net recoveries of $116,000 for the year ended December 31, 2017. Net recoveries related to loans secured by construction and land loans decreased $108,000, or 73.0%, to net recoveries of $40,000 for year ended December 31, 2018, as compared to recoveries of $148,000 for the year ended December 31, 2017.

Mortgage Banking Activity

In addition to the lending activities previously discussed, we also originate single-family residential mortgage loans for sale in the secondary market through Waterstone Mortgage Corporation. Waterstone Mortgage Corporation originated $2.60 billion in mortgage loans held for sale during the year ended December 31, 2018, which was an increase of $52.2 million, or 2.0%, from the $2.55 billion originated during the year ended December 31, 2017. The increase in loan production volume was driven by a 4.1% increase in mortgage purchase products partially offset by a 14.0% decrease in refinance products. Total mortgage banking income decreased $6.7 million, or 5.5%, to $115.4 million during the year ended December 31, 2018 compared to $122.1 million during the year ended December 31, 2017. The decrease in total mortgage banking income is due in part to a decrease in margin of approximately 7.9% for the year ended December 31, 2018 compared to December 31, 2017. We sell loans on both a servicing-released and a servicing retained basis. Waterstone Mortgage Corporation has contracted with a third party to service the loans for which we retain servicing.

Our overall margin can be affected by the mix of both loan type (conventional loans versus governmental) and loan purpose (purchase versus refinance). Conventional loans include loans that conform to Fannie Mae and Freddie Mac standards, whereas governmental loans are those loans guaranteed by the federal government, such as a Federal Housing Authority or U.S. Department of Agriculture loan. Loans originated for the purchase of a residential property, which generally yield a higher margin than loans originated for refinancing existing loans, comprised 90.6% of total originations during the year ended December 31, 2018, compared to 88.8% of total originations during the year ended December 31, 2017. The mix of loan type trended towards more conventional loans and less governmental loans comprising 69.7% and 30.3% of all loan originations, respectively, during the year ended December 31, 2018, compared to 64.5% and 35.5% of all loan originations, respectively, during the year ended December 31, 2017.

Investment Activities

Wauwatosa Investments, Inc. is WaterStone Bank's investment subsidiary headquartered in the State of Nevada. Wauwatosa Investments, Inc. manages the back office function for WaterStone Bank's investment portfolio. Our Chief Financial Officer and Treasury Officer are responsible for executing purchases and sales in accordance with our investment policy and monitoring the investment activities of Wauwatosa Investments, Inc. The investment policy is reviewed annually by management and changes to the policy are recommended to and subject to the approval of our board of directors. Authority to make investments under the approved investment policy guidelines is delegated by the board to designated employees. While general investment strategies are developed and authorized by management, the execution of specific actions rests with the Chief Financial Officer and Treasury Officer who may act jointly in performing security trades. The Chief Financial Officer and Treasury Officer are responsible for ensuring that the guidelines and requirements included in the investment policy are followed and that all securities are considered prudent for investment. The Chief Financial Officer and the Treasury Officer are authorized to execute investment transactions (purchases and sales) without the prior approval of the board provided they are within the scope of the established investment policy.

Our investment policy requires that all securities transactions be conducted in a safe and sound manner. Investment decisions are based upon a thorough analysis of each security instrument to determine its quality, inherent risks, fit within our overall asset/liability management objectives, effect on our risk-based capital measurement and prospects for yield and/or appreciation.

Consistent with our overall business and asset/liability management strategy, which focuses on sustaining adequate levels of core earnings, our investment portfolio is comprised primarily of securities that are classified as available for sale. During the year ended December 31, 2018, no investment securities were sold. During the year ended December 31, 2017, one municipal security with a total book value of $555,000 was sold at a loss of $107,000. During the year ended December 31, 2016, no investment securities were sold.

Available for Sale Portfolio

Mortgage-backed Securities and Collateralized Mortgage Obligations. We purchase mortgage-backed securities and collateralized mortgage obligations guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae. We invest in mortgage-backed securities and collateralized mortgage obligations to achieve positive interest rate spreads with minimal administrative expense, and to lower our credit risk. We regularly monitor the credit quality of this portfolio.

Mortgage-backed securities and collateralized mortgage obligations are created by the pooling of mortgages and the issuance of a security. These securities typically represent a participation interest in a pool of single-family or multi-family mortgages, although we focus our investments on mortgage related securities backed by one- to four-family mortgages. The issuers of such securities pool and resell the participation interests in the form of securities to investors such as WaterStone Bank, and in the case of government agency sponsored issues, guarantee the payment of principal and interest to investors. Mortgage-backed securities and collateralized mortgage obligations generally yield less than the loans that underlie such securities because of the cost of payment guarantees, if any, and credit enhancements. These fixed-rate securities are usually more liquid than individual mortgage loans.

At December 31, 2018, mortgage-backed securities totaled $41.6 million. The mortgage-backed securities portfolio had a weighted average yield of 2.58% and a weighted average remaining life of 4.2 years at December 31, 2018. The estimated fair value of our mortgage-backed securities portfolio at December 31, 2018 was $474,000 less than the amortized cost of $42.1 million. Mortgage-backed securities valued at $1.8 million were pledged as collateral for mortgage banking activities as of December 31, 2018. Investments in mortgage-backed securities involve a risk that actual prepayments may differ from estimated prepayments over the life of the security, which may require adjustments to the amortization of any premium or accretion of any discount relating to such instruments, thereby changing the net yield on such securities. There is also reinvestment risk associated with the cash flows from such securities or if such securities are redeemed by the issuer. In addition, the market value of such securities may be adversely affected in a rising interest rate environment, particularly since all of our mortgage-backed securities have a fixed rate of interest. The relatively short weighted average remaining life of our mortgage-backed security portfolio mitigates our potential risk of loss in a rising interest rate environment.

At December 31, 2018, collateralized mortgage obligations totaled $75.0 million. At December 31, 2018, the collateralized mortgage obligations portfolio consisted entirely of securities backed by government sponsored enterprises or U.S. Government agencies. The collateralized mortgage obligations portfolio had a weighted average yield of 2.65% and a weighted average remaining life of 3.2 years at December 31, 2018. The estimated fair value of our collateralized mortgage obligations portfolio at December 31, 2018 was $968,000 less than the amortized cost of $75.9 million. Investments in collateralized mortgage obligations involve a risk that actual prepayments may differ from estimated prepayments over the life of the security, which may require adjustments to the amortization of any premium or accretion of any discount relating to such instruments, thereby changing the net yield on such securities. There is also reinvestment risk associated with the cash flows from such securities or if such securities are redeemed by the issuer. In addition, the market value of such securities may be adversely affected in a rising interest rate environment, particularly since all of our collateralized mortgage obligations have a fixed rate of interest. The relatively short weighted average remaining life of our collateralized mortgage obligation portfolio mitigates our potential risk of loss in a rising interest rate environment.

Municipal Obligations. These securities consist of obligations issued by school districts, counties and municipalities or their agencies and include general obligation bonds, industrial development revenue bonds and other revenue bonds. Our investment policy requires that such municipal obligations be rated A+ or better by a nationally recognized rating agency at the date of purchase. A security that is downgraded below investment grade will require additional analysis of creditworthiness and a determination will be made to hold or dispose of the investment. We regularly monitor the credit quality of this portfolio. At December 31, 2018, our municipal obligations portfolio totaled $55.9 million, all of which was classified as available for sale. The weighted average yield on this portfolio was 2.37% at December 31, 2018, with a weighted average remaining life of 5.2 years. The estimated market value of our municipal obligations bond portfolio at December 31, 2018 was $706,000 more than the amortized cost of $55.2 million.

As of December 31, 2018, the Company identified one municipal security that was deemed to be other-than-temporarily impaired. The security was issued by a tax incremental district in a municipality located in Wisconsin. During the year ended December 31, 2012, the Company received audited financial statements with respect to the municipal issuer that called into question the ability of the underlying taxing district that issued the securities to operate as a going concern. During the year ended December 31, 2012, the Company's analysis of the security in this municipality resulted in $77,000 in credit losses that were charged to earnings with respect to this municipal security. An additional $17,000 credit loss was charged to earnings during the year ended December 31, 2014 with respect to this security as a sale occurred at a discounted price. As of December 31, 2018, the remaining impaired bond had an amortized cost of $116,000 and a total life-to-date impairment of $94,000.

Other Debt Securities. As of December 31, 2018, we held other debt securities with a fair value of $13.2 million and amortized cost of $15.0 million. Other debt securities consist of corporate bonds. The weighted average yield on this portfolio was 3.56% at December 31, 2018, with a weighted average remaining life of 7.8 years. We regularly monitor the credit quality of this portfolio.

Investment Securities Portfolio.

The following table sets forth the carrying values of our available for sale securities portfolio at the dates indicated.

	At December 31,					
	2018		2017		2016	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In Thousands)					
Securities available for sale:						
Mortgage-backed securities	$42,105	$41,631	$57,351	$57,435	$72,858	$73,413
Collateralized mortgage obligations						
Government sponsored enterprise issued	75,923	74,955	61,313	60,500	62,297	62,002
Government sponsored enterprise bonds	-	-	2,500	2,497	2,500	2,503
Municipal obligations	55,242	55,948	62,516	63,769	70,311	70,696
Other debt securities	15,002	13,186	15,005	14,525	17,399	16,950
Certificates of deposit	-	-	980	981	1,225	1,231
Total securities available for sale	$188,272	$185,720	$199,665	$199,707	$226,590	$226,795

The following table sets forth, by issuer, the amortized cost and estimated fair value of our investments in a single issuer, as of December 31, 2018, that exceeded 10% of our stockholders' equity as of that date.

	At December 31, 2018	
	Amortized Cost	Fair Value
	(In Thousands)	
Fannie Mae	$68,187	$67,196
Freddie Mac	41,821	41,527

Portfolio Maturities and Yields. The composition and maturities of the securities portfolio at December 31, 2018 are summarized in the following table. Maturities are based on the final contractual payment dates and do not reflect the impact of prepayments or early redemptions that may occur. Municipal obligation yields have not been adjusted to a tax-equivalent basis. Certain mortgage related securities have interest rates that are adjustable and will reprice annually within the various maturity ranges. These repricing schedules are not reflected in the table below.

	One Year or Less		More than One Year through Five Years		More than Five Years through Ten Years		More than Ten Years		Total Securities	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
	(Dollars in Thousands)									
Securities available for sale:										
Mortgage-backed securities	$373	4.77 %	$33,339	2.44 %	$2,463	2.56 %	$5,930	3.25 %	$42,105	2.58 %
Collateralized mortgage obligations										
Government sponsored enterprise issued	152	2.90 %	69,772	2.66 %	5,999	2.53 %	-	-	75,923	2.65 %
Municipal obligations	1,990	1.61 %	20,891	1.96 %	31,754	2.65 %	607	4.35 %	55,242	2.37 %
Other debt securities	5,002	2.70 %	-	0.00 %	-	-	10,000	4.00 %	15,002	3.56 %
Total securities available for sale	$7,517	2.51 %	$124,002	2.48 %	$40,216	2.62 %	$16,537	3.74 %	$188,272	2.63 %

Sources of Funds

General. Deposits have traditionally been our primary source of funds for use in lending and investment activities. We also rely on advances from the Federal Home Loan Bank of Chicago and borrowings from other commercial banks in the form of repurchase agreements collateralized by investment securities. In addition to deposits and borrowings, we derive funds from scheduled loan payments, investment maturities, loan prepayments, retained earnings and income on earning assets. While scheduled loan payments and income on earning assets are relatively stable sources of funds, deposit inflows and outflows can vary widely and are influenced by prevailing market interest rates, economic conditions and competition from other financial institutions.

Deposits. A majority of our depositors are persons or businesses who work, reside, or are located in Milwaukee and Waukesha Counties and, to a lesser extent, other southeastern Wisconsin communities. We offer a selection of deposit instruments, including checking, savings, money market deposit accounts, and fixed-term certificates of deposit. Deposit account terms vary, with the principal differences being the minimum balance required, the amount of time the funds must remain on deposit and the interest rate. As of December 31, 2018, certificates of deposit comprised 70.9% of total customer deposits, and had a weighted average cost of 2.01% on that date. Our reliance on certificates of deposit has resulted in a higher cost of funds than would otherwise be the case if demand deposits, savings and money market accounts made up a larger part of our deposit base. Development of our branch network and expansion of our commercial products and services and aggressively seeking lower cost savings, checking and money market accounts are expected to result in decreased reliance on higher-cost certificates of deposit.

Interest rates paid, maturity terms, service fees and withdrawal penalties are established on a periodic basis. Deposit rates and terms are based primarily on current operating strategies and market rates, liquidity requirements, rates paid by competitors and growth goals. To attract and retain deposits, we rely upon personalized customer service, long-standing relationships and competitive interest rates. We also provide remote deposit capture, internet banking and mobile banking.

The flow of deposits is influenced significantly by general economic conditions, changes in money market and other prevailing interest rates and competition. The variety of deposit accounts that we offer allows us to be competitive in obtaining funds and responding to changes in consumer demand. Based on historical experience, management believes our deposits are relatively stable. The ability to attract and maintain money market accounts and certificates of deposit, and the rates paid on these deposits, has been and will continue to be significantly affected by market conditions. At December 31, 2018 and December 31, 2017, $735.9 million and $689.0 million of our deposit accounts were certificates of deposit, of which $472.5 million and $587.3 million, respectively, had maturities of one year or less.

Deposits increased by $71.1 million, or 7.4%, from December 31, 2017 to December 31, 2018. The increase in deposits was the result of a $46.9 million, or 6.8% increase in time deposits and a $24.2 million, or 8.7%, increase in total transaction accounts. The Company had no deposits obtained directly from brokers as of December 31, 2018 and December 31, 2017.

The following table sets forth the distribution of total deposit accounts, by account type, at the dates indicated.

	At December 31,								
	2018			2017			2016		
	Average Balance	Average Cost of Funds	Ending Weighted Average Yield	Average Balance	Average Cost of Funds	Ending Weighted Average Yield	Average Balance	Average Cost of Funds	Ending Weighted Average Yield
	(Dollars in Thousands)								
Deposit type:									
Demand deposits	$96,648								